INDEX

	Page
Opinions below	1
Jurisdiction	2
Questions presented	2
Statute involved	2
Statement	4
Argument	11
Conclusion	15

CITATIONS

Cases:	
Banks Warehouses, Inc. v. *Watt*, 345 U. S. 932	14
Bradley Mining Co. v. *Boice*, 345 U. S. 932	15
Commissioner v. *Culbertson*, 337 U. S. 733	11, 12, 13
Commissioner v. *Tower*, 327 U. S. 280	11, 14
Ford v. *Commissioner*, 19 T. C. No. 29	12
Levin v. *Commissioner*, 199 F. 2d 692	12
Lucas v. *Earl*, 281 U. S. 111	11
Lusthaus v. *Commissioner*, 327 U. S. 293	11
Marcus v. *Commissioner*, 201 F. 2d 850	12
United States v. *Gypsum Co.*, 333 U. S. 364	13–14
Western Pacific Railroad Corp. v. *Western Pacific Railroad Co.*, 197 F. 2d 994, 345 U. S. 247	14
Statute:	
Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, Sec. 6	5
Internal Revenue Code:	
Sec. 22 (26 U. S. C. 1946 ed. 22)	2
Sec. 181 (26 U. S. C. 1946 ed. 181)	3, 13
Sec. 182 (26 U. S. C. 1946 ed. 182)	3, 13
Sec. 3797 (26 U. S. C. 1946 ed. 3797)	3, 13
28 U. S. C. 46	4, 14
Miscellaneous:	
Federal Rules of Civil Procedure, Rule 52	14

256014—53——1

In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 734

ESTATE OF MABEL COCHRAN, DECEASED; SIDNEY ELMER COCHRAN AND DONALD ROBERT COCHRAN, EXECUTORS, AND JOSEPH E. COCHRAN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The *per curiam* opinion of the Court of Appeals (R. 212) is reported at 201 F. 2d 365. A dissenting opinion filed by Judge Pope (R. 230–234) in connection with the denial by the Court of Appeals of a petition for rehearing is reported at 201 F. 2d 365. The memorandum findings of fact and opinion of the Tax Court (R. 186–193) are not reported.

JURISDICTION

The judgment of the Court of Appeals (R. 213) was entered November 12, 1952. A timely petition for rehearing (R. 215–227) was denied by the Court of Appeals on January 23, 1953 (R. 229). The petition for a writ of certiorari was filed on April 20, 1953. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTIONS PRESENTED

1. Whether the Court of Appeals erred in affirming the finding of the Tax Court that in the taxable years involved the two daughters of the taxpayer were not bona fide partners with him for federal income tax purposes.

2. Whether the Court of Appeals erred in acting through the division of three judges who originally heard the case in denying a petition for rehearing *en banc*.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) [As amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind

and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

(26 U. S. C. 1946 ed. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1946 ed. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U. S. C. 1946 ed. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1946 ed. 3797.)

Judicial Code:

SEC. 46. Assignment of judges; divisions; hearings; quorum.

* * * * *

(c) Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in active service. A court in banc shall consist of all active circuit judges of the circuit.

(28 U. S. C. 46 (c).)

STATEMENT

This proceeding involves deficiencies in federal income taxes asserted against Joseph E. Cochran (herein sometimes referred to as the taxpayer)

and the estate of his deceased wife, Mabel Cochran,[1] for the taxable years 1943 and 1944.[2]

For a number of years prior to December 31, 1937, the taxpayer and Bernardo Celli, Sr., owned and operated, as partners, a Chevrolet automobile dealership in Oakland, California, under the firm name of Cochran & Celli. On that date the taxpayer and his wife had four children, Bernice and Winifred (both since married), and Sidney E. Cochran, all of whom were adults, and Donald Robert Cochran, then 17 years of age. Bernardo Celli, Sr., and his wife, Anna, had two sons, Bernardo, Jr., and Lloyd, both of whom were adults. In 1937 the two Celli sons and Sidney Cochran, the adult Cochran son, were employed in the partnership business. (R. 19, 188.)

In order to perpetuate the Chevrolet franchise in their families and to interest their sons in the business, the two partners decided in 1937 to take their sons into the business as partners (R. 189).

On December 31, 1937, the opening credit accounts of the taxpayer and Bernardo Celli, Sr.,

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[1] The date of death is not shown by the record, but it was subsequent to the taxable years involved. Deficiencies were asserted against her estate on the basis of her community interest in the income for the years involved, for which she filed separate income tax returns (R. 22–23, 188).

[2] Computation of the deficiencies for 1943 also involves the income of the taxpayer and his deceased wife for the year 1942 by reason of the tax forgiveness provisions of Section 6 of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126.

on the books of the Cochran & Celli partnership were $242,914.94 and $237,605.44, respectively. As of that date journal entries were made on the partnership books transferring $100,617.43 from the investment account of the taxpayer to a new investment account set up in the name of Mabel Cochran and transferring $102,024.88 from the investment account of Bernardo Celli, Sr., to a new investment set up in the name of Anna Celli. As of the same date other entries were made transferring amounts from the accounts of each of the four parents to accounts set up in the name of each of their respective adult children. (R. 19.) [3]

The above withdrawals from the taxpayer's investment account, the credits to his wife's new investment account, and the crediting of new investment accounts of the Cochran daughters, all were component parts of a single plan to make all members of the Cochran family partners in the business (R. 190).[4]

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[3] Attached as Exhibits 1 through 6 to the stipulation of facts (R. 19–20, 24–29) are excerpts from the investment accounts in the names of the taxpayer, his wife, and their four children on the books of the partnership showing the transfers from one investment account to another during the period from December 31, 1937, through December 31, 1944.

[4] The Tax Court found from the evidence (R. 190) that the withdrawals from the taxpayer's investment account, the credits to his wife's new investment account, the crediting of new investment accounts of the Cochran daughters, and their signing of the new partnership agreement, all took place within the months of November and December 1937.

The partnership agreement of January 1, 1938 (R. 29–43), is comprehensive in its terms. It recites the ownership by the contracting parties of the business theretofore conducted under the firm name and style of Cochran & Celli, provides that the new partnership should continue to conduct the business under the same firm name, assuming all valid obligations, liabilities, or contracts of the business theretofore owned and conducted by the taxpayer and Bernardo Celli, Sr., and sets forth the respective contribution and interest in the business of the several signatories thereto. Among the more important provisions of the agreement of January 1, 1938, are paragraph 4 (R. 31), providing for inclusion of Donald Robert Cochran as a partner upon his attaining legal age; paragraph 5 (R. 31–32), giving to the taxpayer and Bernardo Celli, Sr., as "Managers," absolute and unqualified control of all phases of the partnership business; and paragraph 9 (R. 35), providing for perpetuation of this joint control of the business by members of the two families in the event of the death of either manager by designating as his successor "Manager" the oldest surviving male partner of the deceased manager's family. The agreement was to continue for one year, and on a year-to-year basis thereafter unless some partner gave written notice, in advance, of his desire to dissolve the partnership (Par. 12, R. 36.) Paragraph 24 (R. 42),

services to the business. In 1942, 1943 and 1944 both daughters made regular withdrawals of money from the accumulated profits of the partnership credited to their accounts.

There was no bona fide intent on the part of the copartners of Cochran & Celli and the two Cochran daughters, Bernice and Winifred, either when the partnership was formed or at any other time during the taxable years 1942, 1943 and 1944, that the two Cochran daughters were to be joined with members of the existing partnership of Cochran & Celli for the purpose of carrying on business as a partnership. Bernice Cochran Johnson and Winifred Cochran Irwin were not valid partners for income tax purposes in the business of Cochran & Celli during the years 1942, 1943 and 1944.

The taxpayer, his wife, and their two daughters filed separate individual income tax returns for the years here involved in which they reported in gross income their distributive shares of the partnership income of Cochran & Celli. In determining the deficiencies in tax here involved the Commissioner added to the income reported by the taxpayer and his wife (as community income) the amounts reported by their two daughters as partnership income. (R. 188.)[5]

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[5] Copies of the deficiency notices were attached as exhibits to the petitions filed with the Tax Court (R. 7–8, 10, 12, 14), but are not included in the printed record.

The Tax Court sustained the Commissioner's determination of deficiencies (R. 186–194), and its decision was affirmed by the Court of Appeals (R. 212). Petitioners thereafter filed a timely petition for rehearing *en banc* (R. 215–227), which with Judge Pope dissenting was denied by the division which heard the case originally (R. 229–234). After this petition was denied petitioners filed a document (R. 235–243), entitled "Petition to Vacate Order Denying Petition for Rehearing *in Banc* and Petition for Leave to Reinstate Petition for Rehearing *in Banc*," leave to file which was denied by the same division (R. 245).

ARGUMENT

1. This is another case involving the taxation of income of so-called family partnerships, of which a great many have been passed upon by the courts in recent years. The principles governing the determination of such cases have been fully explored by this Court in *Commissioner* v. *Tower,* 327 U. S. 280, *Lusthaus* v. *Commissioner,* 327 U. S. 293, and *Commissioner* v. *Culbertson,* 337 U. S. 733.

It also is settled by the above decisions and the decisions of this Court, beginning with *Lucas* v. *Earl,* 281 U. S. 111, on which they are based, that the income of a business purportedly conducted as a family partnership is taxable to him who earns it. Furthermore, the determination of this question depends in each instance upon "inquiries into the subjective," *i. e.,* the intent of

the parties in the particular case. *Commissioner* v. *Culbertson, supra,* at p. 743. A reading of the opinions of the various courts of appeals in the cases claimed to be in conflict (*Levin* v. *Commissioner,* 199 F. 2d 692 (C. A. 2); *Marcus* v. *Commissioner,* 201 F. 2d 850 (C. A. 5)), and in the Ninth Circuit does not disclose any disagreement as to the appropriate legal criteria which are to be applied in cases of this character.

Finally, contrary to counsel's suggestion (Pet. 7), we find nothing in the Tax Court's opinion in *Ford* v. *Commissioner,* 19 T. C. No. 29), to indicate that the Tax Court would now reach a different conclusion in the instant case. The Tax Court's decision in the *Ford* case, rather than indicating a "changed" position as assumed by counsel (Pet. 7), seems to be in accordance with earlier Tax Court decisions involving substantially similar facts. Nor do we find anything in the record in the instant case which would require a reversal of the Tax Court's decision. The controlling consideration in these cases, as this Court said in *Commissioner* v. *Culbertson, supra,* p. 742, is whether "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." In this case the Tax Court found as a fact, among other things, that "The two Cochran daughters were included because their father felt morally obligated to give them as much as he gave

his sons" (R. 189). In its opinion the Tax Court added (R. 192):

> Petitioner Joseph E. Cochran testified that the reason he made his daughters partners in the business was to afford them treatment equal to that he had shown his sons. While his motive was commendable, the fact remains the evidence fails to show the existence of any business purpose for bringing either of the two daughters into the partnership or that there was a bona fide intent that the two daughters be joined as partners in the business in question.

The foregoing statements are supported, not only by the record as a whole, but by the testimony of the taxpayer himself (R. 94–126). When the evidence is considered in the light of the purpose of Congress, as expressed in Sections 181, 182, and 3797 (a) (2) of the Internal Revenue Code, *supra,* to tax the earnings of partnerships to the individual members thereof, it cannot be said that the findings of the Tax Court in this case are "clearly erroneous." *United States* v. *Gypsum Co.,* 333 U. S. 364, 395–396; Rule 52 (a), Federal Rules of Civil Procedure. However, "Whether the evidence would have supported a different finding by the Tax Court is a question not here presented." *Commissioner* v. *Tower, supra,* p. 292.

2. Petitioner's argument that the denial of its motion for a rehearing *en banc* was improper

because the denial was made by the division that heard the appeal rather than the full court, is fully answered by the decision of this Court in *Western Pacific Railroad Corp.* v. *Western Pacific Railroad Co.*, 345 U. S. 247. There it is made clear that 28 U. S. C. 46 (c), *supra*, p. 4, does not require any consideration of an individual motion for rehearing *en banc* by the entire court if the court has delegated that function to the divisions. 345 U. S. at 259. Moreover, the situation in this case is distinguishable from that in *Western Pacific*, where the case was remanded, for here the division of the court involved must have acted on the motion on its merits pursuant to the Statement of the Court of Appeals for the Ninth Circuit in the *Western Pacific* case that such would be the practice in the future. *Western Pacific Railroad Corp.* v. *Western Pacific Railroad Co.*, 197 F. 2d 994, 1016.[6] This, therefore, is not a situation where neither the court as a whole nor one of its divisions passed on the motion. This Court has, however, remanded another case to the Court of Appeals for the Ninth Circuit on facts which

[6] In this respect the case differs from *Banks Warehouses, Inc.* v. *Watt*, 345 U. S. 932, where on the authority of the *Western Pacific* case, this Court granted certiorari, vacated the order denying rehearing *en banc*, and remanded the case to the Court of Appeals for Ninth Circuit. There the denial preceded the statement of policy by the Court of Appeals and may have been subject to the same infirmity, that it was not clear whether the division exercised its discretion or acted in the belief that it lacked power.

appear similar to those here involved. *Bradley Mining Co.* v. *Boice,* 345 U. S. 932. Since the action was taken *per curiam,* it is not possible for us to determine the extent to which that case is applicable here. Apart from that, however, there would seem to be no need for remand in this case.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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